



Taming the Deficit

Saving Our Children from Themselves

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Understanding the Deficit

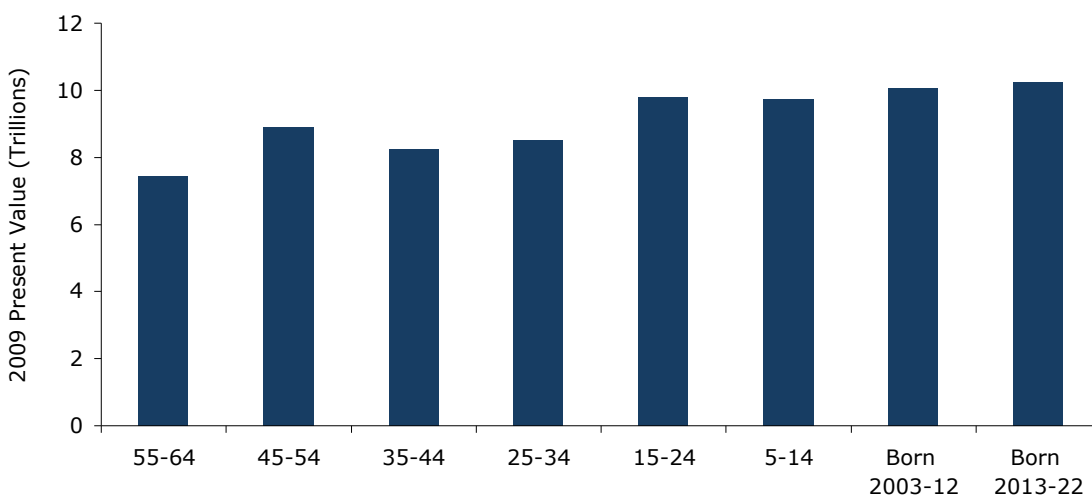
One of the most popular causes among Washington political insiders is reducing the budget deficit. The conventional story in these circles is that current and projected future deficits will place an unbearable burden on future generations. Their argument is that the need to reduce the deficit is a question of intergenerational equity.

The leading spokespeople for this position, such as David Walker, the President of the Peter G. Peterson Foundation, often refer to the country's \$62.1 trillion "real federal financial hole." This figure is even more ominous than the \$11.9 trillion debt figure that the country owed at the end of fiscal year 2009 or the \$16.0 trillion debt figure that the Congressional Budget Office projects for 2019.

However, it seems that very few people have a clear understanding of this debt figure. This figure is not in any way a measure of money transferred from younger generations to older generations. In fact, rather than being a measure of how much debt older generations will pass on to today's young people, to a large extent this ominous debt figure is actually a measure of the debt that today's young people are projected to run up given the current structure of existing programs, most importantly Medicare. In other words, the huge debt numbers that are being used to scare the country – especially the young – are largely projections of how much debt today's young will pass onto future generations.

Figure 1 shows the projected debt burden (benefits received beyond taxes paid) that each ten-year age group is expected to create. All numbers are in 2009 dollars, so they are not affected by inflation. The calculations also assume a 3.0 percent real interest rate to adjust for the different time at which taxes are paid and benefits, like Social Security and Medicare, are received. (See Appendix for further explanation of calculations.)

FIGURE 1
Net Lifetime Federal Benefits by Age Group in 2008



See Appendix for source and methodology.

As can be seen, each cohort is projected to receive benefits that exceed its tax burden, but the gap rises through time, with today's young projected to contribute far more to the country's indebtedness than the baby boom cohorts that are nearing or at retirement age. The net addition to the debt from older baby boomers, people between the age of 55 and 64 in 2008, is projected to be \$7.4 trillion. By contrast, the projected addition to the debt by people in the age group from 15 to 24 – the teens and young people who many deficit fighters see as allies – is projected to be \$9.8 trillion, a debt increment more than 30 percent larger than the debt burden that is attributable to older baby boomers.

The projected burden from younger cohorts is even larger. The cohort between the ages of 5 and 14 is projected to add \$10.1 trillion to the country's debt. The cohort that will be born between the years 2013 and 2022 is projected to add \$10.2 trillion to the national debt, nearly 40 percent more than the older baby boomers. In other words, an honest discussion of the long-term debt problem cannot possibly describe it as a measure of generational transfer from today's young to the elderly. Rather, it is largely a matter of the extent to which future benefits are projected to exceed the taxes paid by today's young and the children yet to be born.

The Cause of the Projected Debt

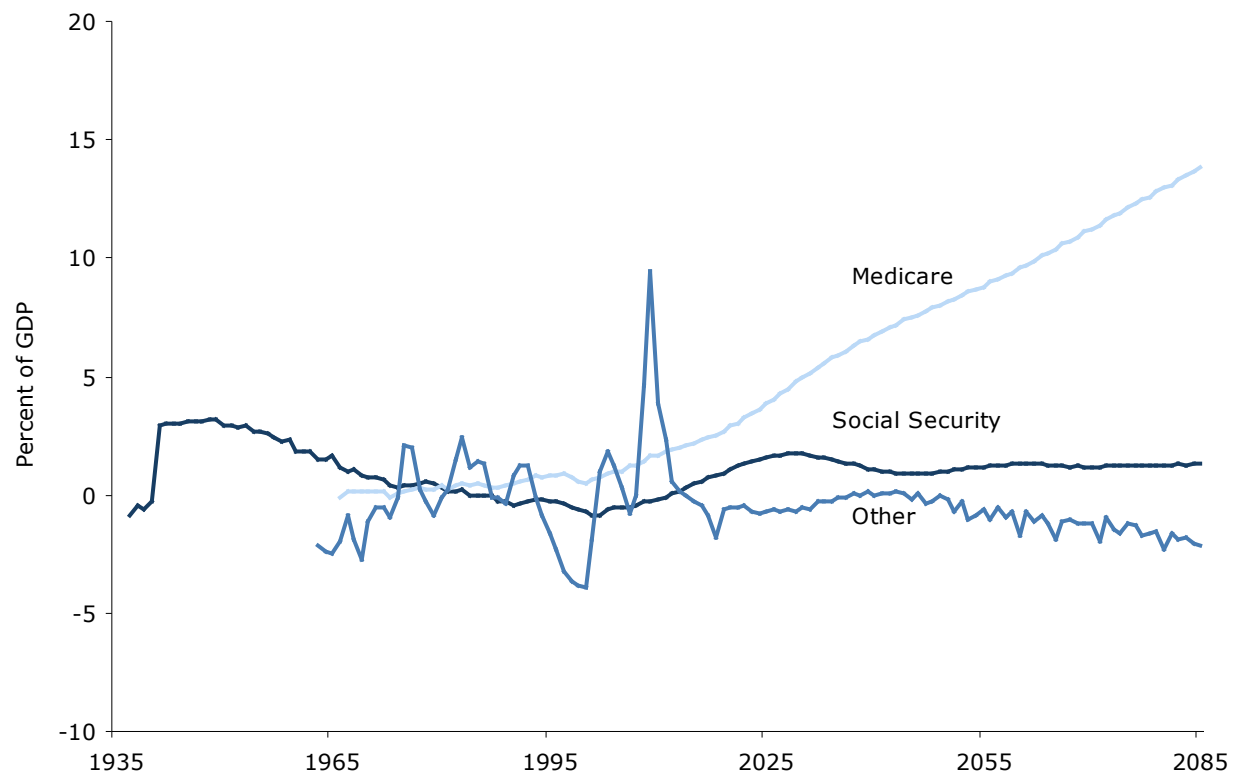
There are two reasons why later-age cohorts are projected to add more to the debt than the generations that preceded them. First, life expectancy is increasing decade by decade and is projected to continue to do so. Life expectancy after age 65 is currently 18.9 years. It is projected to be 23.2 years in 2085. If the tax and benefit formulas for Social Security and Medicare remain unchanged, then the benefits received in these programs will rise through time, as workers collect benefits for a longer period of time.¹

However, increasing longevity is a relatively minor factor in the rising deficit projections. The main factor is that per person health care costs are projected to far outpace the rate of per capita GDP growth. In other words, the main reason that today's young and those yet to be born are projected to impose a far larger burden on the government than their parents and grandparents is that their health care is projected to be far more costly.

Figure 2 shows the annual contribution of Medicare, Social Security, and other components of government spending to the annual deficit over the rest of the century. As can be seen, Social Security, which directly reflects the impact of an aging population, is projected to make a relatively modest contribution to the deficit over this period. At some point, presumably it will be necessary to have some mix of tax increases and benefit cuts to cope with longer retirements, as has been done in prior decades. However, the deficits in question are both distant and relatively modest.

¹ The normal retirement age, the age at which workers can first receive full benefits, is projected to rise to 67 for workers who were born after 1959.

FIGURE 2
Program Contribution to Deficit as Percent of GDP, 1937-2085



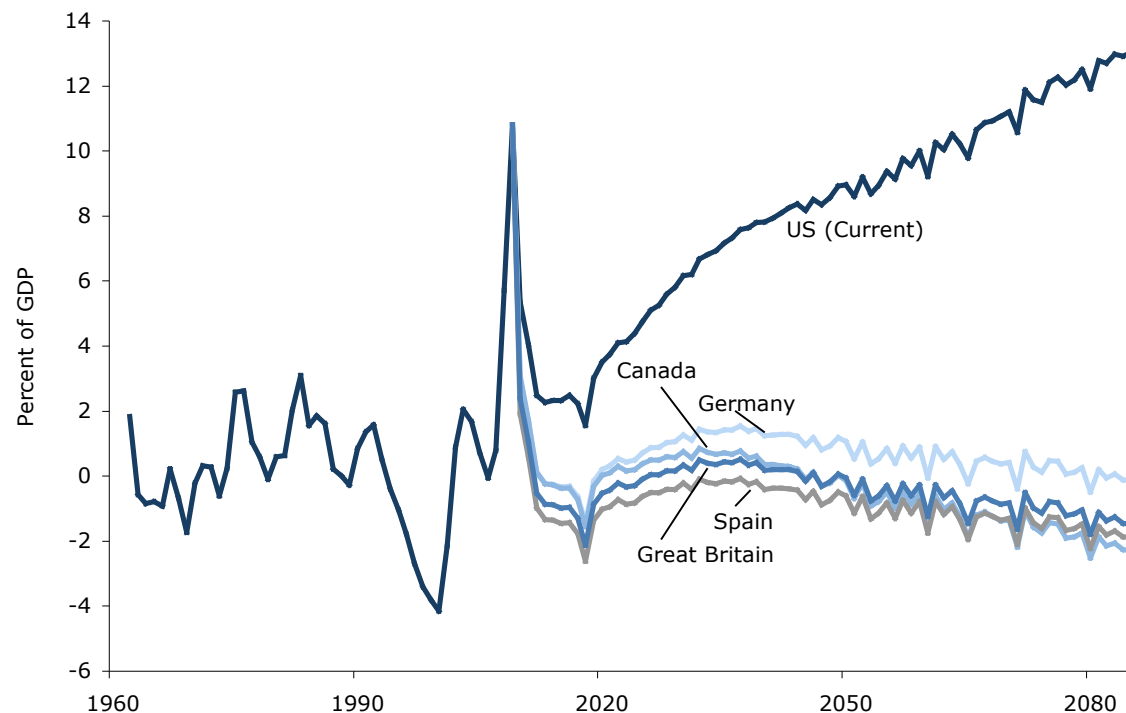
See Appendix for source and methodology.

By contrast, the deficits projected from Medicare are projected to be considerably larger and to grow rapidly in the near future. This is due to the fact that private-sector health care costs in the United States are projected to vastly outpace the rate of income growth. Medicare (and Medicaid) pays for health care purchased from the private sector.

If current projections for private-sector health care cost growth prove accurate, then the burden on the government will be unsustainable. Of course, if private-sector health care costs grow as projected, then the burden of health care costs on the private sector is also likely to prove unbearable. There are likely to be many more companies, such as General Motors and Chrysler, that are bankrupted in large part by health care costs. In short, rather than being a measure of intergenerational equity, or even a measure of government excess, the long-term debt burdens touted in budget debates are simply a measure of the inefficiency of the U.S. health care system.

If the United States had health care costs that were in line with those of other wealthy countries, then the projections would show enormous surpluses, not deficits. **Figure 3** shows long-term budget projections for the United States and then adjusts these projections under the assumption that it has the same per capita health care costs of Germany, Canada, Spain, and the United Kingdom.

FIGURE 3
U.S. Budget Deficit as Percent of GDP under Alternate Health Care Cost Scenarios, 1962-2085



See Appendix for source and methodology.

As can be seen in all of these cases, the United States is projected to run enormous surpluses. For example, if the United States had the same per capita health care costs as Canada, its budget surplus would be equal to 0.13 percent of GDP by 2050. By 2080, its budget surplus would be 2.52 percent of GDP. In short, the budget problem facing the United States is almost entirely an issue of dealing with an out of control health care system, not the old stealing from the young.

Conclusion

The debt is not a measure of intergenerational equity and it is extremely misleading to present it as one. The generations that came of age after World War II were handed the largest debt in the country's history (far larger than the debt levels currently projected), yet enjoyed the greatest period of prosperity the country has ever enjoyed. We hand a whole economy and society down to future generations, including a physical and social infrastructure, a level of development of technology, a level of education, and of course the natural environment. These factors will determine their well being, not the government debt.

It is especially dishonest to portray projected debt levels attributable to a broken health care system as an issue of intergenerational equity. As the calculations in this paper show, future generations are actually projected to contribute more to the deficit by this measure than the current old or near-old. The problem is a broken health care system, not government profligacy.

Appendix: Methodology

Start-of-year population by age (0-99 and 100+) and sex from 1941-2085 was provided by Social Security.

Data on federal taxes and spending as a share of GDP as well as GDP and taxable payroll for years 1962-2083 were projected by the Congressional Budget Office through the Long-Term Budget Outlook. Payroll taxes beyond 2083 were estimated as constant shares of taxable payroll and other taxes as a linearly increasing share of GDP. OASI expenditures were projected to increase with GDP and the projected share of the population age 65 and over. DI expenditures were projected to grow with GDP and the share of the population age 20-64. Medicare expenditures were projected to grow with per-capita GDP, the population age 65 and over, aging of the 65-and-over-population, and 1.1 percent excess cost growth. Medicaid expenditures were projected to grow with GDP, changes in population share by broad age group (0-19, 20-64, 65+), and 0.2 percent excess cost growth. Other federal expenditures were maintained at 10 percent of GDP.

In each year, taxes and spending were variously distributed by age 20 and over. We then computed the 2009 net present value over all years (discounted at a 3.0 percent real rate) applying to each ten-year birth cohort to arrive at the final net federal benefit for the group.